investment is concerned. While each separate proposal may have its supporters or detractors, it is apparent that the package as a whole tends to discourage equity investment and risk-taking by Canadians. We believe that this approach, which reduces the after-tax cash flow of investments and increases the cost of corporate financing, works against Canada's long-term competitive needs.

6.20 We recognize that fiscal considerations preclude any significant tax relief for capital during the first stage of tax reform. It is important, however, to signal to Canadians that the taxation of investment will be subject to more favourable rules in the future. One aspect of this that clearly is feasible in Stage One, is to cap at 66⅔ percent the amount of capital gains that will be taken into income. There are several cogent arguments for this:

- If capital gains are taxed at 75 percent, as projected for 1990 and beyond, this will reverse the recent favourable treatment of capital gains versus dividends and set in motion a process to convert gains to dividends which will surely trigger the anti-avoidance procedure and presumably a raft of specific measures. Capping the gains at two-thirds inclusion will eliminate most of this conversion.
- An inclusion rate of 66⅔ percent roughly offsets the impact of lowering marginal rates so that capital gains (apart from the capping of the lifetime exemption) will be treated similarly pre- and post-reform. (Note that for those in the middle-income class, and particularly for the elderly, the marginal rates, post-reform, are already higher so that even a 66⅔ percent inclusion rate represents harsh treatment of capital gains income.)
- Moving to 75 percent inclusion implies that even modest inflation rates can result in taxes in excess of real returns. Limiting inclusion to 66⅔ percent is not a substitute for indexing gains for inflation, but it is a transitional measure that accommodates this goal.
- The proposal will not affect revenues over the next two years, since the 75 percent rate was intended to come into effect only in 1990. However, the announcement of a 66⅔ percent cap will have a positive effect with respect to investment and will prevent early realization of gains and/or measures to convert gains to dividends.